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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

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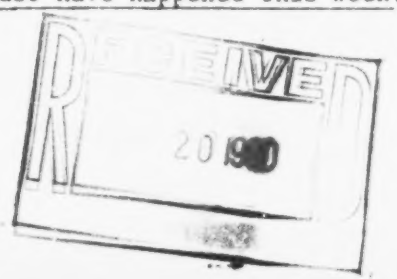
Forecasters expecting a recession suddenly find themselves leaning against the breeze. This is quite a shift from last year when the opposite was true. But leaning against the wind last year was a good place to be and may be once again. The economists who have recently withdrawn their recession forecast are understandably reacting to the current war psychology. But they may be overreacting. Although military spending will be up in the future, it is not likely to have much impact on the economy in 1980. And the increase in spending will result in fewer tax cuts and less money available for other programs, not necessarily higher deficits. The likelihood of an emergency mobilization at this point seems small. The major deterrent to aggression by a major power remains the implied threat of nuclear retaliation, as has been the case throughout the postwar period. A few more F-16s a little bit faster are not likely to add much to this deterrent. A well planned long-run program to deal better with conventional wars seems the alternative that will eventually be decided upon.

Meanwhile, the recession arguments keep getting better and better. Leading indicators have been declining now for 10 months. Their typical lead time for a recession is 9-12 months; by this reckoning we are now vulnerable. And the further financing of increases in retail sales through further declines in the savings rate seems unlikely to continue as the consumer begins to worry about rising unemployment. So far, the recession has been a cerebral event. It's been talked about, but there haven't been any gut fears. These tend to feed on themselves and are produced by actual layoffs and the prospect of corporate cost-cutting drives caused by falling profits. The unemployment rate in January seems to have begun to rise, and falling profits may not be far behind. Finally, the auto industry has been in a recession for about nine months, but housing has so far held up fairly well. Weakness in housing in conjunction with weakness in autos has typically meant a slide in aggregate business activity, and the housing industry is likely to be weak in the first half of 1980, considering the significantly lower housing starts and permits figures registered at the end of 1979.

The inflationary war psychology that is in the air has produced an unusual divergence in the fixed income markets. Typically short- and long-term rates move together, but this has not been the case in recent weeks. Long-bond yields this week were at record highs and up a significant 100 basis points from the first of the year. Short-term rates, on the other hand, have changed very little. Ninety-day CD rates, for instance, have traded from 13.30 to 13.60 this year. They are down 100 basis points or more from the peak of the rate spike last October. If the recession takes hold soon, it appears that short rates have peaked and that the peak occurred in October. On the other hand, if long rates have peaked, it must have happened this week.

Gordon B. Pye



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Money Market Rates

	2/1/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	15.25%	15.25%	11.75%
Effective since	12/7/79		
Discount Rate at Federal Reserve Bank	12.00	12.00	9.50
Federal Funds	13.38	14.00	10.00
Repurchase Agreements	12.38	12.40	9.55
U.S. Treasury Issues - Yields			
Bills			
3 months	12.60	12.87	9.55
6 months	12.82	12.98	9.80
1 year	12.42	12.36	10.00
Coupons			
2 years	11.81	11.82	9.50
4 years	11.20	11.04	8.80
7 years	11.20	11.05	8.82
10 years	11.14	11.09	8.87
Long Bond	11.12	10.96	8.84
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.15	13.50	9.80
3 months	13.40	13.55	10.00
6 months	13.55	13.75	10.30
1 year	13.20	13.25	10.00
Bankers' Acceptances			
1 month	13.20	13.30	9.70
3 months	13.50	13.60	9.80
6 months	13.60	13.85	9.85
Eurodollar Deposits			
1 month	13.94	14.25	10.31*
2 months	14.19	14.44	10.50
3 months	14.25	14.63	10.56
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	12.00	12.50	9.00
1 month	12.25	13.00	9.75
3 months	13.00	12.00	9.63
Bank Holding Companies			
1 month	13.05	13.05	9.75
Dealer Placed:			
3 months	13.25	13.15	9.90
New Aa Corporate Utility Bond	12.50	12.40	9.55
Tax Exempt			
6 month Project Notes	5.70	5.85	5.05
12 month Project Notes	N/A	N/A	5.25
20 year AAA Bond	7.00	7.00	5.70

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

Cable Address: "Irvingbank" Telex: I.T.T. 420268 · R.C.A. 232241 · W.U.I. 62832 · French 82629